Review of the Tropical Forest Investment Fund

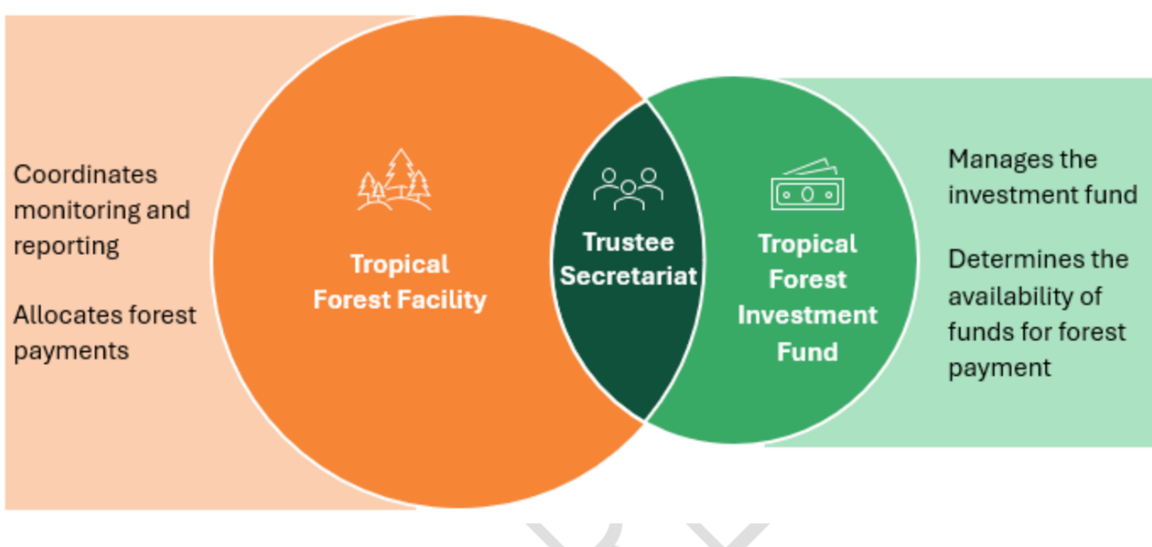
Third World Network[1], May 2025

1. Introduction

The Tropical Forest Forever Facility (TFFF) is a proposed international funding mechanism designed to reward tropical forest countries (TFCs) for conservation results through a novel financial structure. It is essentially envisioned as a pay-for-performance fund operating like a multilateral sovereign wealth fund, where the net investment returns are channeled as payments to countries that protect their forests. The proposed mechanism aims to mobilize large-scale finance (in the order of $125 billion) by leveraging global capital markets. In theory, this allows wealthier developed nations to support forest conservation via financial engineering to generate returns for TFCs.

The mobilizing and raising of financial resources to fund annual payments to the participating TFCs will be undertaken by a related entity called the Tropical Forest Investment Fund (TFIF), while the TFFF will be responsible for managing the forest cover rewards system and for distributing the channeled funds from the TFIF to the eligible and deserving TFCs.

Figure 1. TFFF Governance Scheme



Source: TFFF Concept Note 2.0, Pg. 7

[1] This Review was written by Goh Chien Yen, in consultation with Lim Li Ching, Meena Raman and other colleagues from the Third World Network.

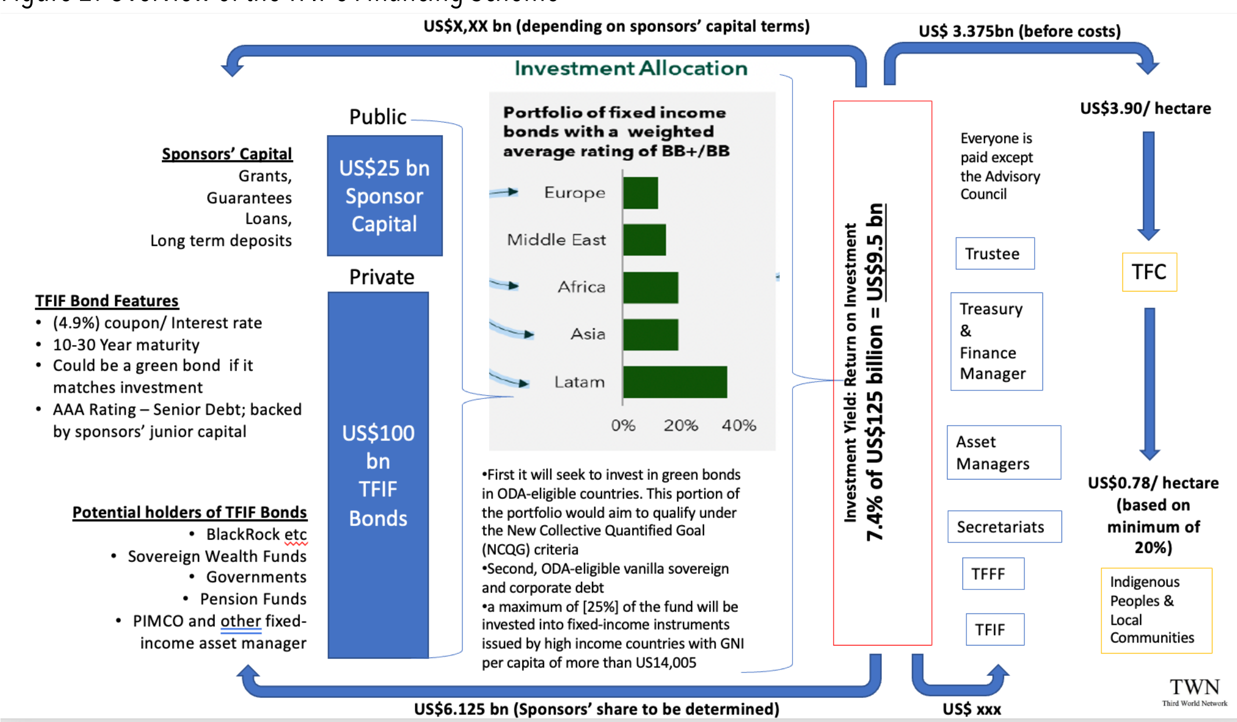
The TFFF will also engage with TFCs interested in participating in the TFFF with regard to their forest monitoring systems and will facilitate those systems' certification for TFFF eligibility purposes. The TFFF will also gather information from TFCs about their forest cover on an annual basis. Modern satellite monitoring would verify each participant country's forest protection performance, triggering payments per hectare of forest conserved.

It is important to stress at the outset that while the goal of mobilizing resources for tropical forests is paramount and provides incentive to TFCs to continue protecting their forests, the TFFF initiative should be seen as without prejudice to the obligations of developed countries to provide financial resources to developing countries for such purposes. In addition, while we welcome the stated goal of providing at least 20% of the payments to Indigenous Peoples and local communities, in recognition of their critical roles in forest stewardship, this review does not address these issues.

This review does not focus on the TFFF per se, but is focused on a critical analysis of the TFIF proposal – examining its financing structure, ethical and practical implications, governance model, risk/return mechanisms, and institutional arrangements – and offers recommendations to strengthen the design. The goal is to inform policymakers, particularly from a developing country perspective, about the strengths and pitfalls of the TFIF and suggest ways to improve transparency, fairness, and alignment with environmental objectives.

2. Financing Structure of the TFIF

Figure 2: Overview of the TFIF's Financing Scheme



Author's chart based on the Concept Note 2.0

How it works: The TFIF's financial model relies on a combination of public and private capital in a layered "capital stack." Sponsor countries (developed nations or other donors) would provide about $25 billion in junior capital (likely as grants, guarantees, or loans), which acts as a cushion against losses. Junior capital, sometimes called subordinated capital, is the tranche of financing that ranks below senior debt. Providers of junior capital are contractually paid only after senior lenders receive their interest and principal payments. On top of this, the TFIF would issue around $100 billion in TFIF bonds to private and institutional investors. This essentially creates a leverage of 4:1 between commercial debt and initial funding. The bond investors hold the senior claims and are promised a fixed interest return, while the sponsor capital is subordinate (taking losses first if investments underperform). This capital stack structure is intended to make the TFIF bonds very safe (potentially AAA-rated due to the junior capital protection), thus attracting large pension funds, insurance companies, sovereign wealth funds, and other fixed-income investors.

Sponsors' capital: As yet, there is insufficient detail and information as to the exact nature of the junior capital to be provided by the sponsor countries, whether it would be low interest loans, an interest-yielding investment, guarantees or grants. Each of these would have its own financial implications for the TFIF, as this would determine its average cost of financing and ultimately the amount flowing to TFCs. Furthermore, without more clarity, it would be hard to assess the exact nature and quantum of the sponsors' financial contributions to this global conservation effort.

The Concept Note 2.0 recognizes that the specific investment terms will differ from sponsor to sponsor, depending on the legal nature of the funds the sponsor commits as junior capital in the TFIF's capital stack.

It starts with the basic assumption that if the sponsor capital is not a grant, it would be treated as interest-yielding, coupon-paying investment. However, the coupon or the interest to be made by the sponsor should be around the prevailing long-term (10-30 years) US treasury bond yield (which is around 4.5 to 5.0%) or the "equivalent in the currency" of the sponsor's junior capital contribution. This is because some non-US denominated sovereign bond issues have lower yields, such as those issued by the Germans or the Japanese.

It is also anticipated that such contributions could also be in the form of a guarantee. The guarantee is a legally-binding promise by the sponsor to meet the scheduled debt servicing obligations of the TFIF. In this case, the guaranteed amount will be treated the same as the other sponsors' actual contribution, "but would require additional market borrowings", according to the Concept Note 2.0. It is not clear, and the Concept Note 2.0 makes no mention of, whether some fee will be paid for providing such guarantee. Other forms of contributing to this junior capital include long-term deposits at concessional rates.

All in all, the more expensive the junior capital stack is, if all the sponsors' contribution are in effect coupon-paying investment, the higher the overall cost of borrowing would be for the TFIF, which leaves less for the TFCs. In this regard, grant commitments from sponsors would be best, as it does not entail borrowing costs for the TFIF. This will also honour the legal principles established under the UNFCCC and CBD that oblige the provision of such financial resources from the developed to developing countries.

Bond and interest strategy: With the credit enhancement provided by the junior capital, the TFIF assumes that it can issue its own bonds with a high rating of AAA, which indicates that the investment is safe and carries low risk of default. As such, it is able to offer institutional investors an interest or coupon payment at a "targeted cost of capital that is comparable to the cost of MDB senior debt"[2]. In October 2023, MDB bonds had an average duration of 3.5 years and yield of 5%.

Figure 2 – FTSE MDB Index Characteristics

INDEX CONSTITUENTS	COUNT	MARKET VALUE (USD bn)	WEIGHT (%)	INDEX CREDIT RATING	YIELD TO MATURITY (%)	EFF DUR	OAS (BPS)
AFRICAN DEVELOPMENT BANK	5	9.67	6.7	AAA	4.97	2.97	13.16
ASIAN DEVELOPMENT BANK	28	35.96	25	AAA	5.02	3.36	10.93
EUROPEAN BANK FOR RECON & DEV	4	8.88	6.2	AAA	5.2	2.5	22.92
INTER-AMERICAN DEVELOPMENT BANK	19	35.96	25	AAA	4.98	3.65	11.65
INTERNATIONAL BANK FOR RECON & DEV	26	35.96	25	AAA	4.98	3.78	11.04
INTERNATIONAL DEVELOPMENT ASSOCI	4	6.03	4.2	AAA	5.05	3.53	19.2
INTERNATIONAL FINANCE CORP	7	11.38	7.9	AAA	5.1	2.63	9.28
FTSE MDB INDEX	**93**	**143.83**	**100**	**AAA**	**5.01**	**3.41**	**12.24**

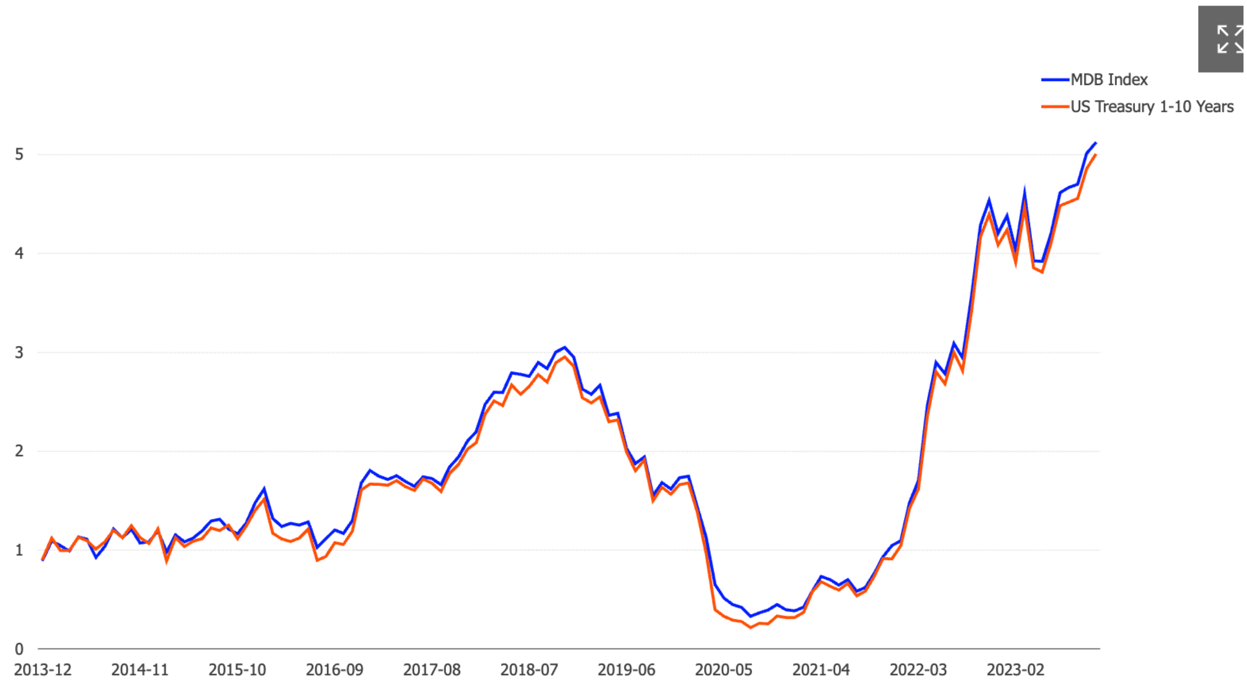
Source: FTSE RUSSELL, as of 1st October 2023

Data from the FTSE MDB Bond Index show that MDB bonds have also historically tracked very closely to the US Treasury mid- to long-term bonds.

[2] Pg. 7, Tropical Forest Forever Facility (TFFF) Concept Note 2.0 Version for Discussion

Modelling exercises conducted by the authors of the Concept Note 2.0 indicate that 20% of junior capital is required in order for the remaining 80% of the capital raised from the market to be rated at AAA.

FIGURE 1 – YIELD TO MATURITY COMPARISON OF THE FTSE MDB INDEX AND THE FTSE US TREASURY 1-10 YEARS BOND INDEX



Consequently, "TFIF's weighted average cost of total capital must be at or below that of highly rated sovereign or supranational borrowers in the debt capital markets."[3] In short, this would be around 4.5-5%, looking at current long-term US treasury bond yields.

Investment portfolio: According to the Concept Note 2.0, the TFIF's portfolio would be a globally diversified fixed-income investment pool, skewed towards emerging markets debt. According to the proposal, the fund will first seek to invest in green bonds in ODA-eligible (developing) countries, then followed by regular (vanilla) sovereign and corporate bonds from ODA-eligible countries[4]. In other words, the bulk of investments are in developing country bonds – likely government bonds and possibly some corporate bonds – where yields are higher. However, to manage risk, up to 25% of the fund may be invested in bonds from high-income countries (with GNI per capita above about $14,000).[5] This cap on high-income countries' market assets ensures most money flows to developing markets while allowing some safer holdings. It is also envisaged that a portion of

[3] Pg. 28, Supra n.2
[4] Pg. 27, Supra n.2
[5] Ibid

the investments made by the TFIF in emerging market green and sustainability bonds could be counted towards the highly contentious issue of the New Collective Quantified Goal (NCQG), that was decided at COP 29.[6]

The return: As pointed out in the Concept Note 2.0, "difference between the weighted average cost of TFIF's funding and the return on its investment portfolio will fund the annual results-based grant payments"[7]. In plain speak, the spread between what the TFIF expects to earn from its investment (~7–9%) and what it pays to bondholders (~4.5--5%) is the source of funds for conservation payments to the TFCs. Using its own example in the Concept Note 2.0, if the TFIF raises $125 billion and achieves a 7.6% return, it would generate about $9.5 billion annually. After paying roughly 4.9% interest to investors (about $6.125 billion), the remaining 2.7% net return ($3.4 billion per year) would be available to reward TFCs (this equates to an envisioned $4 per hectare of forest protected per year).[8]

The structure: The TFIF's financing model potentially unlocks sizeable sums for conservation by tapping private capital at scale, rather than relying solely on grants. The use of a blended finance approach (public money absorbing risk to crowd-in private investors) is a much-touted strategy in development finance, but not without its criticisms. While the sponsors put their capital at risk, it is envisaged that they too will enjoy a return from their financial contribution at no more than a highly rated, long-term security in the currency of their contribution. Based on calculations mentioned in the Concept Note 2.0, economic risks to the sponsors are represented to be small (between 0.24% to 1.14%)[9] due to the "credit protection provided by the surplus of the investment income relative to the forest payments made to TFCs."[10] If all goes well, sponsors would get their principal back after 40 years, plus interest, and investors would earn a steady market return from an ultra-low risk investment, while tropical forest nations receive billions in performance-based payments. This leverage and sustainability of funding (recycling returns rather than one-off aid) are cited advantages.

Despite its promising appeal, the financing structure of the TFIF raises some issues:

Who's really paying? A central concern with the TFIF proposal is the paradox in its financing: the returns used to reward tropical forest conservation are largely generated from the developing countries themselves, via their debt servicing and payments to international investors and in this case, the TFIF.

According to the TFIF's design, the TFIF would borrow $125bn from sponsors and market investors, and invest this heavily in emerging market bonds that are arguably mispriced in terms of risk (i.e. higher interest than their true default risk might warrant). By exploiting this, the TFIF earns a profit and passes it back to TFCs as conservation payments. The TFIF will be making its return on such investments from taking advantage of the flaws and inequities in the global financial system that has disadvantaged many a TFC. The real money in this

[6] Pg. 27, Supra n.2
[7] Pg. 26, Supra n.2
[8] Ibid
[9] Pg. 28, Supra n.2
[10] Pg. 29, Supra n.2

sense will therefore come from developing countries themselves, disguised by the international capital markets as 'natural' return on investments. In other words, much of the funding is not a transfer from rich to poor countries, but rather value extraction from poor countries' own high borrowing costs. Furthermore, both the TFIF bondholders and even the sponsor countries' capital must be paid back in full and with interest, meaning the ultimate source of funds is actually the developing world's payments on their debt obligations.

In effect, money circulates from the Global South to the TFIF (as fixed income), and is then given back to the TFC members – some of whom will be issuing sovereign bonds, picked up by the TFIF – as "reward" for forest conservation. This raises the question: Is the TFIF truly providing new financing, especially from developed countries and private capital to TFCs, or is it recycling financial resources from the developing countries?

In this regard, to also include the TFIF's planned purchases of developing countries' green and sustainability bonds as part of the developed countries' commitment towards the already emaciated $300bn NCQG target seems like a creative way to dilute their obligations further, when developing countries' climate financing needs are upwards of at least a trillion dollars.

3. Ethical and Practical Issues

Fairness and additionality: For tropical forest nations, a mechanism that pays them with one hand what they've paid out with the other (via debt servicing) might appear disingenuous. The TFIF is presented as biodiversity finance or reforestation incentive, yet it would largely recycle existing financial flows from the Global South and at times from those same TFCs (albeit from different budgets – finance ministries paying debt vs. environment agencies receiving forest funds). The international legal principle of biodiversity finance is understood to mean new and additional support from developed nations (as in grants or concessional finance) to help developing countries meet their commitments. The TFIF somewhat blurs this, since the sponsors' true cost might be limited to how they make their junior capital contributions. It is true that sponsors are taking on risk to make the scheme work, but the final concession may be modest relative to the total fund size and their investment terms. In fact, if sponsor countries or their institutions also end up buying TFIF bonds (because 4.9% AAA bonds are attractive), they could even earn income from the scheme, further muddying who ultimately is contributing the resources.

Dependence on debt markets: Relying on international capital markets means that forest conservation funding becomes entangled with the vicissitudes of global financial conditions. If investors lose appetite for emerging market bonds or if global interest rates rise sharply (making its issuances less attractive), the TFIF might struggle to raise the $100b in bonds. Similarly, if a significant number of developing countries face debt distress, the very source of TFIF's profits could dry up or be seen as exacerbating those countries' debt burdens. Investing predominantly in developing country bonds means the TFIF is fundamentally relying on emerging markets' debt yields to fund forest protection. Emerging market bonds tend to have higher interest rates to compensate for higher risks (credit risk, currency risk, etc.). The TFIF is effectively planning to profit from this risk premium. This introduces significant exposure to emerging market economic cycles, interest rate fluctuations, and default risks. A downturn or series of defaults in the issuing countries' debt markets could impair TFIF returns and thus the funds available for conservation payments. At the same time, improving economic conditions in the emerging markets could also reduce the return on investments for the TFIF.

Perception and legitimacy: From an optical standpoint, the notion that rich-country sponsors avoid "encumbering" their finances (as the concept notes) while effectively using poorer countries' risk premiums to fund environmental goals could be controversial. Some might argue this is a clever win-win, but others might see it as shifting the burden to developing nations in yet another form. The success of an initiative like the TFIF will depend on trust and buy-in from all stakeholders. Thus, being transparent about this structure is important. It may be worth explicitly acknowledging this issue in the TFIF's communications and ensuring that TFCs see net meaningful financial gains for their forest conservation efforts. For instance, the costs of running the TFIF should not be more than a certain percentage of the conservation payments they receive.

Handling default or downgrades: Because the TFIF will hold a large amount of sovereign bonds of developing countries, eventually some issuer may face distress or default during the life of the facility (40 years or more). The proposal needs a clear policy on how the TFIF will act in such cases, as it has a unique character; it is a public-purpose fund but is also a large-scale commercial creditor. Several important questions arise:

- Will the TFIF, as a bondholder, support mechanisms like automatic debt suspension or relief clauses in the event a country is hit by a crisis (for example, natural disaster clauses or pandemic clauses that pause debt payments)? Or will it insist on full payment to maximize returns?
- Will the TFIF invest in or encourage issuance of state-contingent debt (like GDP-linked bonds, sustainability-linked bonds with performance triggers, etc.) that might align financial outcomes with a country's economic or governance progress? Such instruments can advance development goals but might offer lower yields or complex returns.
- How will the TFIF behave in a sovereign debt restructuring scenario? Will it join creditor committees and push for terms like a commercial investor would, or will it take a more lenient stance given its mandate and institutional character? This is critical because if a TFC that is part of the TFFF has to restructure its debt, the TFIF being a major creditor could be conflicted – essentially an entity tied to the global community's forest initiative might be suing or pressing one of its beneficiary countries for repayment.
- Will the TFIF invest in bonds of the very countries that receive forest conservation payments (TFFF member countries)? If yes, it directly intertwines with their fiscal health; if no, it limits the investment universe (and perhaps the political attractiveness of the scheme to those countries). Both options have their dilemmas. Investing in member countries' bonds could be seen as plowing money back into them (beyond forest payments), but it also means that if those countries run into trouble, the TFIF is exposed.

- Ultimately, would the TFIF ever pursue legal action to enforce debt contracts against an emerging market sovereign? Some commercial creditors do litigate to recover debts. The TFIF doing so would be politically complicated, given its public-purpose nature.

These questions highlight that the TFIF's design has to reconcile being a fiduciary to the capital providers with being an international funding mechanism for the TFFF. To maintain credibility, the TFIF should adopt a responsible creditor approach: for instance, to be ready to participate in debt restructuring processes rather than holding out. It could adopt investment policies that favor countries with sound debt management and environmental policies, to reduce the chance of default and ensure alignment of incentives.

Fiduciary duty vs. environmental and human rights objectives: Perhaps the most telling example of this conflict is posed by this question: if a sovereign issues a green bond aimed at biodiversity conservation with lower coupon or with provisions such as allowing payment suspension upon achieving certain sustainability milestones (thus offering lower financial return), and alternatively the same sovereign issues a regular bond with higher yield, which will the TFIF choose? Purely financially, the TFIF might choose the higher-yield vanilla bond to maximize returns for the facility. But that would contradict the very purpose of the TFFF, which is to support positive environmental action, particularly for forests and the peoples who depend on them. In other words, there is a risk that the TFIF's investment choices could undermine its raison d'être – for instance, by preferring investments that have nothing to do with forest protection or even investing in sectors counter to conservation (e.g., bonds of companies or governments linked to deforestation activities). The proposal does note that it might qualify some investments under climate finance criteria, but it does not promise that all investments will be green. While it may be too restrictive to force every investment to reinforce TFFF objectives (given the need for portfolio diversification), the TFIF should not be investing in assets that undermine or work against the objectives of the TFFF. This implies establishing a negative screen or ESG safeguards in the investment mandate (e.g., no bonds from companies severely implicated in deforestation or human rights abuses of Indigenous Peoples and local communities who steward forests, or no investment in a country's bond if that country is actively reversing forest protection policies).

The fiduciary conflict can be managed by governance and guidelines: if the TFIF Board sets clear investment policies that integrate environmental criteria, then the asset managers will have to balance both return and impact. Additionally, sponsor countries could accept slightly lower financial returns from the TFIF in exchange for higher environmental integrity – for example, allowing the fund to invest in more green bonds even if the yield is a bit less, with sponsors absorbing the difference as part of their contribution. This would turn what is currently a strict profit-seeking fund into a more blended objective fund. However, this is a fine line, because if returns dip too low, there would not be enough funding for the conservation payouts or to satisfy bondholders. One solution might be for sponsors to provide a little more capital or guarantees specifically to cover any yield gap for environmentally preferable investments.

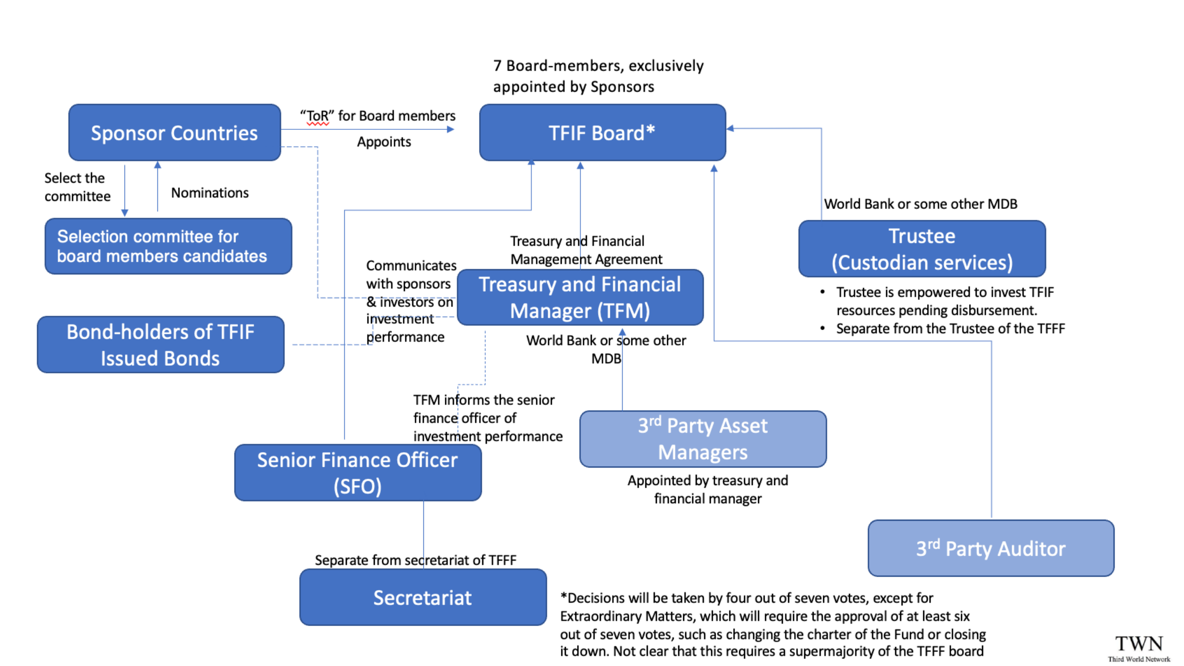
In summary, the ethical critique of the TFIF is that it might appear to "generate" biodiversity finance, but in reality, it leverages developing countries' own debt repayments. This does not mean that the TFIF has no merit –

but it underscores the importance of acknowledging who ultimately pays. The principle of environmental justice would argue that TFCs – often lower-income – should be supported by grants or truly concessional funds from wealthier nations. The TFIF's architects argue that traditional funding has been insufficient, so this market-based approach is a pragmatic solution; however, polices to enhance additionality, debt sustainability, and equitable benefit-sharing will need to be factored in, given the objectives and character of the TFIF and its related TFFF.

The TFIF's dual mandate – to generate financial returns for investors and to deliver on forest conservation objectives – can create tension. This section examined how the proposal addresses risk and return, and where more clarity is needed. In essence, many of these risk/return questions are currently unanswered in the proposal and warrant detailed guidelines. Transparency, predefined policies, and alignment with international norms (e.g. supporting debt relief, adhering to ESG investment principles) will be crucial to manage this balance. Without clear answers, policymakers (especially from TFCs) may be nervous that they are hitching their forest protection plans to a financial engine that could one day prioritize its balance sheet over their well-being. Crafting the TFIF's operating rules to explicitly incorporate its higher purposes will mitigate these risks (see Section 5 for specific recommendations).

4. Governance Arrangements

The governance and organisational structure of the TFIF will determine who controls decisions and how interests are represented. As it stands, the current proposal concentrates decision-making power heavily among the sponsor countries and financial managers, with relatively little or no representation from the TFCs, their Indigenous Peoples and local communities, nor the TFFF itself.



Source: Author's chart based on the TFFF Concept Note, 24 February 2025 Version.

It appears the TFIF will be managed by its own separate Board, distinct from the Board of the umbrella Tropical Forest Forever Facility (TFFF) and its governance structure. The TFIF will be established as an independent investment fund and exists as its own legal entity while sharing a Secretariat with the TFFF.[11] In this regard, the TFIF is even more of a legal entity in its own right than the TFFF which is proposed as a Financial Intermediary Fund (FIF) under the likely auspices of the World Bank, according to the Concept Note 2.0.[12]

Implementing the TFIF involves a constellation of institutions, each with specific roles: sponsor governments, a trustee, a treasury/financial manager, asset managers, a TFIF Board, a Secretariat and a host of third parties. Getting this institutional design right is vital for accountability and efficiency. A review of the proposed setup identifies potential concerns, as detailed below.

Sponsor dominance of the TFIF Board: According to the Concept Note, "It is proposed that Sponsor Countries establish a set of qualifications (Terms of Reference, 'ToR') for Board members and appoint an independent selection committee to identify candidates who meet these qualifications. Sovereign Sponsors would nominate and appoint the Board, selecting from the independent committee's recommendations."[13]

The TFIF Board represents the highest executive layer of the TFIF, responsible for the strategic direction and effective functioning of the fund. Regrettably, according to the Concept Note 2.0, Board members are to be exclusively chosen by the sponsor countries (donors), with no input envisaged from the TFCs or the TFFF for which it is raising funds.

The sponsor countries formulate the ToR for Board members and appoint what is described as an "independent" selection committee. However, this committee is not tasked with developing the criteria, nor is it clear how the committee itself will be constituted. The committee appears to function more like a recruitment agency for the sponsors rather than identifying the most appropriate candidates based on the objectives, purposes, and institutional character of the TFFF and the TFIF. This veneer of governance is further exposed by the fact that nomination and appointment of Board members will ultimately be determined solely by the sponsor countries.

The Concept Note 2.0 envisions absolutely no involvement from the TFFF and its TFC members at any stage of this crucial process. They are therefore excluded from the appointment of the most important executives and decision-makers for the fund. They have no role in crafting the ToR, no involvement in appointing the selection committee, and will not nominate or appoint Board members.

More critically, such a Board will neither be independent from the sponsors nor be perceived as such. The Board will, in effect, be reporting to the sponsors. This dynamic is compounded by the fact that sponsors will also set

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[11] Pg. 6, Supra n.2
[12] Pg. 7, Supra n.2
[13] Pg. 46, Supra n.2

the compensation and overall budget of the TFIF[14]. In essence, the sponsors are shadow directors, controlling the TFIF from behind the Board.

The sponsors occupy multiple, potentially conflicting roles. They are the initial funders (providing the $25 billion junior capital and financial backing). They will appoint the core of the TFIF governance (effectively controlling all TFIF appointments) and, by extension, heavily impact the TFFF. They have a vested interest in the success of the scheme, both environmentally as Board members of the TFFF and financially, to recoup their capital contributions. They could also subscribe to TFIF bonds – wearing donor, investor and fiduciary hats simultaneously.

If the TFIF is to be a truly collaborative international effort, greater representation of tropical forest nations is essential. At minimum, there should be a balanced governance structure or a mechanism for those countries to influence investment policies, as the success of the entire scheme rests on their cooperation in forest conservation.

When a small group of sponsor countries or institutions holds most of the power — such as selecting Board members and setting rules — there is a risk of decisions that favor their interests or perspectives over others. For example, if major financial decisions require Board approval, sponsors could theoretically prioritize safeguarding their capital or achieving financial returns over maximizing payouts to TFCs.

The TFIF should therefore incorporate balanced representation, transparency (such as publishing Board decisions and allowing independent evaluation), and robust conflicts of interest policies. Board members and managers must disclose any interests, including whether their country stands to benefit from certain investments.

In conclusion, the governance of the TFIF currently skews toward those providing the money, while those undertaking the forest conservation — TFCs, Indigenous Peoples and local communities — have little say. For a facility meant to serve global public goods and developing nation interests, this represents a critical flaw. Improving governance is not merely about fairness; it will lead to better outcomes by bringing more perspectives and buy-in. When TFCs are involved in decision-making, they can help ensure the TFIF invests and operates in ways that are sensitive to on-the-ground realities and aligned with conservation objectives.

TFIF Board: The TFIF Board is arguably the most powerful office in the entire setup encompassing both the TFIF and the TFFF. The Concept Note 2.0 states that the Board will comprise seven members with essentially only one area of expertise, training and experience: "in the management and investment of financial assets and in the mobilization of capital on global capital markets."[15] As discussed, the Board is currently sponsor-dominated and will make all decisions regarding the "strategic direction" of the TFIF, its investment decisions, and key appointments. In relation to releasing funds to the TFFF for payments to the TFCs, the TFIF Board will effectively

[14] Pg. 46, footnote 28, Supra n.2
[15] Pg. 46, Supra n.2

make the final decision. The Board is also tasked with assessing the financial stability and integrity of the TFIF in light of the proposed payment, "if it is deemed sustainable, it will inform the Facility to proceed with allocations," according to the Concept Note 2.0.[16]

Insofar as the Board has some measure of accountability, it must communicate with sponsors and investors on the fund's performance. However, it has no ostensible reporting line to the TFFF or its TFC members.

The Board is also empowered to amend the TFIF charter without consultation with the TFFF or TFC members. All it must do is inform the TFFF Board "as [and when] appropriate." Only in the extraordinary circumstance of a decision to terminate the TFIF would a decision from the TFFF Board be required.[17]

The draft bylaws in the Concept Note 2.0 indicate that decisions generally require four out of seven votes, with certain extraordinary matters requiring at least six votes. The concern is not the voting threshold itself, but rather who sits on the Board. If all seven members are essentially from sponsor countries or their appointees, with highly similar professional profiles, there is a real risk of groupthink.

Board membership will not be a full-time position, but Board members will be compensated for their role. As mentioned above, the compensation package will be determined by the sponsors.

Treasury and Financial Manager (TFM): The TFM will be the workhorse of the TFIF. According to the Concept Note 2.0, it will be "preparing [and administering] funding, risk management, investment management, and liquidity policies [of the TFIF]… This includes… managing asset allocation (such as cash reserve requirements), mitigating currency risks, ensuring sustainable withdrawal levels for forest payments…and managing all aspects of the [$125bn] TFIF bond issuing program"[18]. However, it will not be in the employ of the TFIF, but in a contractual relationship with the TFIF to offer these services under a Treasury and Financial Management Agreement. According to the Concept Note 2.0, the TFM is also empowered to hire asset managers to outsource some of its key functions. It is not clear at this juncture what is the delineation between the TFM and asset managers, especially around investment management.

It is envisaged that this role would be undertaken by an MDB, possibly the World Bank. However, if the World Bank is appointed as both trustee and TFM, that would be a lot of eggs in one basket. Alternatives like splitting those roles among different MDBs should be considered (e.g., perhaps use different regional development banks and other MDBs as TFM to diversify).

Asset managers: Given the scale, the TFIF would probably use multiple professional asset management firms or institutions to invest the funds under the oversight of the TFM. These could be large private asset managers (BlackRock, PIMCO, etc., which have been mentioned as potential TFIF bond buyers but could also manage

[16] Pg. 32, Supra n.2
[17] Pg. 47, Supra n.2
[18] Pg. 48, Supra n.2

segregated mandates) or public institutions with asset management capacity. Any appointed asset manager must meet the highest ethical and legal standards – they should have no history of fraud, market manipulation, money laundering, corruption, etc., basically "beyond reproach". This is very important because a scandal with the fund's investments could taint the whole initiative. Additionally, it is recommended that the same stringent integrity criteria be applied to all arrangers, bookrunners, legal counsel, etc., involved in issuing the TFIF bonds. Essentially, the TFIF should set a high bar for ethical conduct for everyone handling its money – given the character and purposes of the fund.

Trustee: The Trustee wields considerable power over the TFIF's financial operations, even though it is only contracted to provide financial administrative services, raising questions about accountability and risk distribution. While tasked with safeguarding fund resources separately from its own assets, the Trustee enjoys broad discretionary authority to invest these funds however it sees fit, with taxpayer-funded contributions bearing all investment losses while the Trustee faces no financial downside.[19]

The governance structure appears complex, with the Trustee receiving disbursement instructions from multiple sources – the TFIF Board, Treasury and Financial Manager, and Secretariat's Senior Finance Officer – potentially creating confusion over ultimate authority and decision-making responsibility.

Notably, the Trustee can pay itself "reasonable costs" from the fund's resources, creating a built-in conflict of interest where the institution determines its own compensation. The arrangement also permits the same multilateral development bank to serve as trustees for both the TFIF and TFFF, even if their accounts are kept separate, concentrating significant financial control in a single institution.[20]

While the Trustee provides annual audited reports, the extensive powers granted – from investment decisions to expense determinations – suggest limited ongoing oversight of day-to-day operations, relying heavily on the Trustee's self-regulation and good faith.

Secretariat: The TFIF will have its own Secretariat distinct from that of the Facility. While both Secretariats may be provided by the same host institution (likely a multilateral development bank), they are functionally and hierarchically distinct, each reporting to its own Board and with separate mandates. The TFIF Secretariat is to be headed by a Senior Finance Officer who is appointed by the TFIF Board. While the TFFF Secretariat is headed by a CEO reporting to the TFFF Board.

Senior Finance Officer: The TFIF's core financial functions will be performed by the Treasury and Financial Manager, asset manager(s) and the Trustee as service providers to the TFIF, according to the Concept Note. Hence, the Senior Finance Officer will play a vital role and "be the full-time "eyes and ears" of the TFIF."[21]

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[19] Pg. 49-50, Supra n.2
[20] Pg. 37, Supra n.2
[21] Pg. 47, footnote 30, Supra n.2

According to the Concept Note 2.0, the Senior Finance Officer "shall be a senior finance professional with skills and experiences in investment management, capital markets and project finance."[22]

World Bank: The World Bank's potential role deserves special attention, as it has been mentioned as a likely Secretariat, Trustee, and Treasury and Financial Manager for the TFIF as well as the TFFF. The World Bank is deeply involved in many tropical forest countries – providing loans, technical advice, even funding forest conservation programs. If the Bank is simultaneously the trustee (holding TFIF and TFFF funds, albeit in separate accounts), the TFM (investing in developing countries', including TFCs', bonds), and an advisor to countries on forest finance, this "multiple hats" situation creates potential conflicts of interest. For instance, could the World Bank be inclined to invest TFIF funds in its own bonds? Would it enforce hard financial discipline on a country, while investing in that country's bonds on behalf of the TFIF? These overlapping roles could lead to perceptions of bias or self-dealing, even if unintentional. This calls for careful delineation of responsibilities and possibly choosing different institutions for different roles or even different institutions for the same roles to ensure diversification, fair dealing and avoiding conflicts of interest. (See Recommendations section below)

Relationship between the TFFF and the TFIF: The relationship between the TFIF and the TFFF presents significant governance challenges. Currently, TFCs, the TFFF Advisory Council, and the TFFF Board have no formal role in the governance and functioning of the TFIF. This separation is problematic, particularly given that the TFIF was originally established as the financing arm of the TFFF.

As currently envisaged, the TFIF would operate with excessive autonomy, creating a governance gap that undermines accountability. While the TFIF emerged as part of the TFFF framework, its complete independence raises serious concerns about institutional coherence and oversight. A stronger degree of accountability of the TFIF to the TFFF is essential to ensure alignment with broader forest conservation objectives.

Certain critical decisions that the TFIF makes about its own operations should require TFFF approval. If the TFFF – with input from TFCs, Indigenous Peoples, local communities and the Advisory Council and broader stakeholders – establishes overall goals and principles, then the TFIF should be accountable to these frameworks rather than pursuing a purely financial and investment management agenda. The current connection between the TFIF and TFFF is, however, administrative at best, extending only to some minimal overlapping Secretariat functions.

Recommended Accountability Framework

Accountability must operate on multiple levels through clear mechanisms:

Vertical accountability

The TFIF Board and Treasury and Financial Manager (TFM) should also report to the TFFF Board. This raises the question of whether the TFFF should operate as an independent entity rather than as a Financial Intermediary

[22] Pg. 49, Concept Note 2.0

Fund (FIF) under the World Bank or other MDB – an issue requiring further consideration. Regular reporting and oversight relationships could strengthen this accountability. For example, TFFF Board approval might be required for annual investment strategies or certain risk limits. Current plans do not contemplate upward accountability to the TFFF as the broader governing entity.

External audit and evaluation

Independent auditors should conduct annual financial and performance audits. These auditors should be appointed by the TFFF or the TFC members, rather than by the same institution(s) contracted to perform these tasks. Additionally, an evaluation mechanism should assess whether the TFIF/TFFF effectively delivers on environmental outcomes. Critical questions include: After five years of operation, is deforestation actually decreasing due to these payments? Are there unintended consequences? Many international funds include independent evaluation units or commission periodic external evaluations to address these questions.

Public transparency

Publishing key documents will enable external oversight, including by NGOs, researchers, and the press. Essential documents for public release include:

- Investment guidelines
- Quarterly and annual portfolio performance reports
- Lists of TFIF investments (with appropriate delays for market sensitivity)
- Information on TFIF bondholders and sponsors' capital and payment amounts

Given the significant public funding involved and the public good objectives, high transparency standards are warranted and would help deter misuse of funds.

Managing conflicts of interest

Clear rules must address potential conflicts of interest. For instance:

- Board members representing sponsor countries should not improperly influence investments that directly benefit their own financial interests
- When the World Bank or other MDBs serve multiple roles, conflict-of-interest firewalls are essential
- If the World Bank serves as trustee and/or TFM, it should recuse itself from decisions about selecting asset managers when its own treasury department bids for that role

Clear terms of reference and codes of conduct for all key actors should outline these expectations.

Alternative and multiple candidates

The institutional architecture is necessarily complex to handle a $125 billion fund with dual objectives. However, the main governance concerns can be summarized as: avoiding excessive concentration of power in one institution, meaningfully including TFCs in governance, and ensuring that every actor's role is well-defined to prevent overlaps and gaps.

To mitigate concentration risk, the TFIF could engage multiple providers for financial services rather than relying on a single TFM and trustee. Potential candidates include the New Development Bank (NDB), Asian Infrastructure Investment Bank (AIIB), regional MDBs, or reputable commercial banks. This multi-partner approach could:

- Distribute risk and prevent any single entity from dominating
- Ensure cost-competitive services
- Increase stakeholder buy-in (for example, China through AIIB participation, or enhanced regional representation through other institutions)

This approach merits exploration during the detailed design phase.

In conclusion, the TFIF/TFFF requires a coherent institutional framework that combines the agility of a financial fund with the inclusiveness of a public multilateral forest conservation initiative. Achieving appropriate checks and balances through governance design and carefully defined institutional roles will determine whether the global community views both the facility and its investment arm as trustworthy and legitimate. Success depends on balancing financial efficiency with democratic accountability, ensuring that this significant international investment serves its intended environmental and planetary objectives.

5. Some Recommendations

Based on the analysis above, several policy recommendations emerge to address conflicts of interest, improve governance, ensure transparency, and align the TFIF's financial strategy with its environmental goals. These recommendations are aimed at policymakers shaping the TFIF:

- **Balance governance and representation**: Restructure the governance arrangements so that TFCs have a strong voice in decision-making, not just sponsor countries. For example, TFFF member countries should be involved in designing and formulating the purpose and mandate of the TFIF Board. They should also be involved in drafting the ToR for the TFIF Board members, nominations and the selection committee. And most importantly, in the appointment of the TFIF Board. This will improve legitimacy and ensure decisions consider on-the-ground realities. Important strategic decisions (e.g., changes to the fund's charter, closure, major risk policy shifts) should require approval by a supermajority or consensus that includes these representatives, preventing unilateral moves by a sponsor-appointed TFIF Board. Additionally, consider co-chairing arrangements (one from a sponsor, one from a tropical forest country) for any TFIF joint committees, to signal shared ownership.

- **Strengthen oversight and accountability:** Establish clearer accountability links between the TFIF (investment fund) and the TFFF (the broader facility). The TFIF should report to the TFFF Board on how its investments are performing relative to the environmental mission, not just financially. Certain decisions of the TFIF Board (for instance, investment policy that could affect eligibility of countries or reputational risks) should be subject to review or veto by the TFFF Board to ensure alignment with conservation objectives. The proposed TFFF Advisory Council with representatives from Indigenous Peoples, local communities, civil society and technical experts should be given a formal role in regard to the TFIF (such as the ability to review and comment on the TFIF's annual plans and results). This ensures voices beyond governments and banks are heard and puts moral pressure on the fund to stay mission-focused and operative at high levels of integrity.

- **Mitigate conflicts of interest (institutional roles):** Avoid any single institution accumulating excessive control. If the World Bank (or any MDB) is selected as Trustee, consider not having the same institution serve as the TFM – instead, split roles between institutions (e.g., one MDB as trustee/custodian, another as TFM). This creates internal checks and could bring complementary strengths (one might be good at financial management, another at investment management). Alternatively, have a competitive process for the TFM role open to various MDBs or qualified entities, which can foster innovation and cost-effectiveness. Establish a clear conflict of interest policy: for instance, if the Trustee is also a lender to a developing country, it must not use insider information or influence TFIF investment decisions about that country's bonds. All service providers (trustee, TFM, asset managers) should sign on to a code of ethics specific to the TFIF's public mission.

- **Diversify and collaborate:** Embrace a multi-institutional model where possible. The TFIF could partner with regional development banks (Asian, African, Inter-American, etc.) to manage portions of the portfolio or to act as regional hub trustees. This spreads risk and builds broader political support. It could also potentially lower costs: for example, issuing local-currency bonds or "Panda bonds" (Renminbi-denominated bonds in China) via institutions like the Asian Infrastructure Investment Bank (AIIB) or the New Development Bank (NDB) might lower the TFIF's average funding costs, which directly increases the surplus available for conservation. By diversifying issuance across currencies and markets, the TFIF might reach a wider investor base and reduce over-reliance on one market. However, ensure the overall currency risk is managed if investments are multi-currency. The point is to not put all eggs in one basket institutionally or geographically.

- **Ensure financial transparency and prudence:** Publish the key financial assumptions and ongoing performance of the TFIF. Policymakers should insist on a public prospectus or blueprint that details its average cost of borrowings, return targets, default assumptions, and how shortfalls/surpluses will be handled. Thereafter, annual reports should detail the actual WACC achieved, returns, and how much money was paid out to countries versus how much was retained. Such transparency builds trust and allows independent analysis. Also, adopt prudent financial policies: e.g., maintain a reserve fund from initial returns to buffer against future losses, and set position limits (no more than X% of portfolio in one country or one issuer) to avoid over-concentration. Communicating these policies to all stakeholders will reassure them that the fund is being run responsibly and not as a high-risk venture.

- **Adopt responsible code of conduct as creditor**: Make a clear policy that the TFIF will act as a responsible and patient creditor in line with its mandate of supporting TFC developing countries. Concretely, the TFIF should support debt relief initiatives if any of its sovereign bond investments are in distress – for instance, by honoring any agreed debt suspension (the TFIF could even preemptively incorporate hurricane clauses or similar into the bonds it buys, encouraging such practices). It should also explore innovative bonds that align with sustainability (like sustainability-linked bonds where interest payments adjust downwards if environmental goals are met, but that are not punitive, if they are not), even if they offer slightly lower yield, as long as the overall objectives can support it. By doing so, the TFIF leverages its unique position to improve the quality of finance for developing countries, not just exploit flaws in the system. These stances can be codified in an investment policy approved by the Board – e.g., "The TFIF will prioritize investment in instruments that include climate or development-friendly features and will participate cooperatively in any debt restructuring consistent with international frameworks." This helps guard against the conflict of interest of acting purely commercially when that would harm the facility's beneficiaries.

- **Integrate environmental criteria into investment decisions:** To align investment strategy with environmental goals, develop a set of ESG (Environmental, Social, Governance) guidelines or exclusions for the TFIF portfolio. At minimum, ensure no investment goes to activities antithetical to forest conservation or that harms forest communities – for example, avoid bonds issued by companies whose business relies on deforestation or by governments actively encouraging forest clearance (unless those governments are part of TFFF and reforming). The TFIF should perform an environmental due diligence for the sovereign bonds of forest countries: if a country is violating its forest protection commitments, the TFIF could limit new investments in that country's bonds (while of course maintaining any existing holdings responsibly). Conversely, if a country issues a green or forest bond, TFIF could preferentially invest to support that effort. In short, create a feedback loop: the TFIF's investments should, wherever possible, complement its conservation mission. This might slightly constrain the universe of high-yield opportunities, but it ensures the TFIF doesn't inadvertently fund the problem it is trying to solve. Any marginal reduction in return from such choices can be seen as part of the sponsors' contribution (after all, sponsors have agreed to the TFIF to protect forests, not just to make money).

- **Enhance monitoring, evaluation, and learning**: Set up an independent monitoring and evaluation framework from the start. This could involve a third-party such as a university or think tank consortium that tracks both financial performance and forest conservation outcomes. They would verify forest cover data (alongside or utilizing the satellite system) and evaluate if the financial incentives are truly contributing to policy changes and reduced deforestation. Regular evaluations (every 2-3 years) should be reported to the governance bodies and the public. For example, if payments are not sufficiently reaching Indigenous Peoples and local communities or not influencing policy, the mechanism can be adjusted (e.g., increase per hectare payments, or require a larger share to go to

Indigenous Peoples and local communities). This adaptive learning approach will ensure that the TFIF remains effective and on mission.

With these adjustments, the TFFF and its investment arm, the TFIF, could become a groundbreaking model that synergizes finance and climate action, rather than a contentious scheme. The recommendations above aim to resolve conflicts of interest, empower the rightful stakeholders, increase transparency, and firmly orient the investment strategy towards supporting tropical forests. Policymakers designing the TFIF should embed these principles early, as course-corrections later would be difficult once billions are at play.

In summary, the TFIF has potential – mobilizing $125 billion for forests could indeed be a forest finance tool like no other, as proponents say. But to fulfill this potential, its governance and operations must reflect the very values of sustainability and equity that it seeks to promote. By implementing robust governance, aligning financial incentives with environmental outcomes, and upholding accountability, the TFIF could truly serve TFCs and global environmental objectives. It is in the interest of all sponsors and partners to heed these recommendations: they would not only avert criticisms and ethical pitfalls, but also create a stronger, more stable mechanism capable of delivering the dual dividends of financial returns and forest conservation.